

Office of Chief Counsel  
Internal Revenue Service

**memorandum**

CC:NER:OHI:CIN:TL-N-2890-99  
JEKagy

date:

to: Chief, Appeals Division, Ohio District  
Attn: Rick O'Connor

from: Assistant District Counsel, Ohio District

subject: [REDACTED]

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By an undated memorandum (see Attachment 1) you sought our advice regarding the proper classification of a remittance received by Examination under the circumstances described below. This memorandum responds to your question regarding the proper characterization of a [REDACTED] remittance in the amount of \$ [REDACTED] made by the taxpayer regarding its [REDACTED] and [REDACTED] tax years.

ISSUE:

Whether a remittance in the amount of \$ [REDACTED] submitted by [REDACTED] on [REDACTED] regarding its [REDACTED] and [REDACTED] tax years should be considered a payment of tax or a cash bond.

CONCLUSION:

We believe that the proper classification of the \$ [REDACTED] remittance submitted by [REDACTED] on [REDACTED] regarding its [REDACTED] and [REDACTED] tax years is as a cash bond.

FACTS:

On [REDACTED], prior to the commencement of the Service's audit of [REDACTED] (" [REDACTED] ") returns for the [REDACTED] and [REDACTED] tax years, [REDACTED] submitted a \$ [REDACTED] remittance to the Service. Accompanying the remittance was a letter (see Attachment 2) of even date which contained the following:

As we have previously discussed, the [REDACTED] [REDACTED] [sic] desire to prepay and thereby stop the interest accumulation on the [REDACTED]-[REDACTED] adjustments anticipated as a result of our previous settlement with the Internal Revenue Service, which changed our publishing affiliates' method of reporting from the cash method to the accrual method as of [REDACTED].

The accompanying letter, which did not contain instructions that the payment was to be treated as a cash bond as had earlier years' letters, also provided the following instructions for the application of the funds:

	[REDACTED]	[REDACTED]	<u>TOTAL</u>
Tax Adjustment	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]
Interest Thereon	[REDACTED]	[REDACTED]	[REDACTED]
	<u>\$ [REDACTED]</u>	<u>\$ [REDACTED]</u>	<u>\$ [REDACTED]</u>

The Payment Posting Vouchers (see Attachment 3) prepared regarding the remittance denominated the payment as a "cash bond" (although the "Send 316(C)" blocks were not checked) and allocated the remittance between the tax years as requested by the taxpayer. In the "REMARKS" section, each of the Vouchers carried a typewritten notation specifying that the amount applied to each tax year should be allocated between tax and interest in a manner consistent with the taxpayer's instructions.

According to the taxpayer, [REDACTED], from the taxpayer's tax department, was present during the generation of the Vouchers and the reason the allocation between tax and interest was typed on the Vouchers was to show the taxpayer's intent that the remittance be treated as an advance payment of

tax and because the "cash bond" box had been checked. But see IRM 4485.2(7)(g) (upon acceptance of an advance payment whether before or after a deficiency has been determined, in filling out a Form 3244-A, Payment Posting Voucher, the REMARKS section should contain "the amount of payment allocated for tax and interest as well as any special instructions ... and "Cash Bond" should be checked "only for ADVANCED PAYMENTS ACCEPTED BEFORE THE DEFICIENCY CAN BE DETERMINED.")

The taxpayer suggests that it made the payment as a result of an anticipated settlement with Appeals for a prior cycle. No information was present in the materials reviewed by this office which established or verified the date such agreement was executed by the parties.

According to a memorandum prepared by Senior Attorney James Hill in July 1993 (see Attachment 4), the Service's audit of [REDACTED] and [REDACTED] tax returns commenced on [REDACTED]. Parenthetically, the [REDACTED] tax year reflected an NOL of approximately \$[REDACTED]. Regardless, a Form 5701 relating to the cash to accrual method issue was not issued until [REDACTED] and was superseded by a Form 5701 dated [REDACTED].

The taxpayer asserts that it "knew" that the method change issue, which in [REDACTED] was about to be settled with Appeals for the prior cycle, would result in significant carryover adjustments in the [REDACTED]-[REDACTED] tax years. In support, [REDACTED] has supplied Appeals with a work sheet, dated [REDACTED] and initialed by [REDACTED], in which the taxpayer prepared a "rough" calculation of the anticipated adjustments of approximately \$[REDACTED] to the [REDACTED] and [REDACTED] years' returns resulting from the agreed method change. [REDACTED] suggests that the "rough" calculation, coupled with the necessary section 446 adjustments which it thought would be associated with the method change issue (but which apparently never materialized), justified its position that tax would be owed on the [REDACTED] and [REDACTED] returns, even considering the large NOL reflected on the [REDACTED] return.

#### ANALYSIS

A deposit in the nature of a cash bond is not a payment of tax, is not subject to a claim for credit or refund and, if returned to the taxpayer, does not bear interest. Deposits in the nature of a cash bond are not made in satisfaction of a tax liability, but function merely to stop the running of interest. Here, the intent of the taxpayer's argument is to obtain the payment of interest on the \$[REDACTED] which was held by the Service from [REDACTED] until its return to the taxpayer [REDACTED].

In addressing prepayments, IRM 4485.1(1) broadly defines "advanced payments" as "all payments intended for application to anticipated, pending, or proposed deficiencies or additional assessments...". The taxpayer seizes on this idea to suggest that since its prepayment was an advanced payment, that must mean it was an advance payment of anticipated tax and could not be viewed as a cash bond. Such argument is without merit. The taxpayer's argument ignores IRM 4485.1(2) and (3). IRM 4485.1(2) clarifies that "[h]ow advance payments are classified depends upon whether the deficiency or additional tax due has already been ascertained." On that point, IRM 4485.1(3) explains that:

[p]ayments tendered before the deficiency may be assessed, e.g., unagreed cases, will be treated by the Service as a cash bond for the payment of taxes thereafter found to be due upon the receipt of an affirmative statement from the taxpayer acknowledging the conditions of acceptance.

Thus, the taxpayer's inference that the term "advance payment" denotes an advance payment of tax, is simply in error. Any advance payment must be classified according to whether a deficiency has been ascertained. As in the present case, where the advance payment precedes the Service's determination of a deficiency, the IRM mandates that advance payment be classified as a cash bond.

The taxpayer suggests that Rev. Proc. 84-58 supports its claim that the advance payment is properly classified as an advance payment of tax, not a cash bond. In particular, the taxpayer cites section 4.02, *Deposits in the nature of a cash bond*, as initial support for its position. In that regard, section 4.02, subpart 1, states in part:

A remittance made before the mailing of a notice of deficiency that is designated by the taxpayer in writing as a deposit in the nature of a cash bond will be treated as such by the Service.

There seems to be no dispute that the remittance was made prior to the statutory notice and was not designated by the taxpayer as in the nature of a cash bond. The taxpayer seems to imply that since the remittance failed to designate the payment as a cash bond, section 4.02 requires that the remittance may not be classified as a cash bond. Such argument is unpersuasive. Cash bonds can be made by a taxpayer both before and after issuance of the statutory notice. See, e.g., subpart 2 of section 4.01. Section 4.02 only provides that in certain circumstances, the Service will automatically recognize a remittance as a cash bond.

Absent those special circumstances, other sections of the revenue procedure determine the proper classification of the remittance.

Cited by the taxpayer in conjunction with section 4.02 as support for its position is section 4.03, *Payments of tax*. Section 4.03, subpart 1, states in part:

A remittance not specifically designated as a deposit in the nature of a cash deposit will be treated as a payment of tax if it is made in response to a proposed liability, for example, as proposed in a revenue agent's or examiner's report, and remittance in full of the proposed liability is made.

Admittedly, the taxpayer's December remittance was "not specifically designated" as in the nature of a cash bond. A remittance, however, will be treated as a payment of tax only if it was made in response to a proposed liability from the Service. In this instance, the [REDACTED] remittance preceded the commencement of the audit, and consequently preceded any proposed liability from the Service. Since [REDACTED] remittance failed to satisfy the requirements of section 4.03, section 4.03 offers no authority for the classification of the December remittance as a payment of tax.

The taxpayer argues, however, that since its remittance was specifically allocated between tax and interest, its remittance was "designated" and it would be improper to treat the remittance as anything other than a designated payment of tax. In other words, according to the taxpayer, it would be improper to resolve this remittance classification issue by reference to section 4.04, entitled *Undesignated remittances*, since the remittance was, in essence, "designated". In that regard, section 4.04, subpart 1, states in part:

Any undesignated remittance not described in section 4.03 made before the liability is proposed to the taxpayer in writing (e.g., before the issuance of a revenue agent's or examiner's report) will be treated by the Service as a deposit in the nature of a cash bond.

The taxpayer allocated the disputed remittance between tax and interest. The taxpayer's suggestion that such an allocation causes the payment to be a "designated" payment for purposes of the revenue procedure is erroneous. The designation described in the procedure is the designation of the remittance "as a deposit in the nature of a cash bond", not the allocation of the remittance between tax and interest. For purposes of section

4.03, the [REDACTED] remittance was not designated, i.e., it was not specifically designated as a deposit in the nature of a cash bond. Of more importance, while section 4.03, *Payments of tax*, applies to remittances not specifically designated as a deposit in the nature of a cash bond (as in the instant case), it applies only if the remittance is made in response to a proposed liability. Here, as noted earlier, no proposed liability was made by the Service prior to the remittance and the remittance was not made in response to a proposed liability. Section 4.03 is simply inapposite.

A remittance not specifically designated as a deposit in the nature of a cash bond yet outside the coverage of section 4.03 (because not in response to a proposed liability), is controlled by section 4.04, *Undesignated remittances*. The taxpayer did not specifically designate the [REDACTED] remittance as a deposit in the nature of a cash bond. By definition, the December remittance was an "undesignated" remittance. As of the date of the taxpayer's submission of the undesignated remittance, the Service had not issued a proposed liability. According to section 4.04, any undesignated remittance, i.e., one not specifically designated as a cash bond, made before the liability is proposed to the taxpayer in writing will be treated by the Service as a deposit in the nature of a cash bond. Consistent with Rev. Proc. 84-58, the instant undesignated remittance, made prior to the Service issuing a proposed liability, must be treated as a deposit in the nature of a cash bond.

The taxpayer suggests that because it believed that it could calculate its potential tax liability, its undesignated remittance should be considered akin to one made in response to a proposed liability. We have found no support within the revenue procedure for the taxpayer's position. To the contrary, section 4.04 is clear that the liability that triggers the remittance must be a liability "proposed to the taxpayer in writing." Calculations generated by the taxpayer fail to satisfy the revenue procedure.

Finally, the taxpayer suggests that it is permitted, at the beginning of the audit, to inform the Service of adjustments in the Service's favor and make an advance payment of tax (not a cash bond) associated with the adjustments. The taxpayer does not and cannot suggest that it made the instant remittance to avoid imposition of accuracy-related penalties under section 6662. Nevertheless, the taxpayer suggests that if any advance payment regarding non-proposed liability is considered a payment of tax, then [REDACTED] payment in this instance must be given similar treatment. Such a suggestion is groundless. That the Service, either as a result of a Congressional mandate or through

the legitimate exercise of regulatory authority, permits a taxpayer's voluntary payment to be considered a payment of tax in one limited instance neither requires nor permits any other pre-liability payment to be considered a payment of tax, absent the specific satisfaction of the requirements of Rev. Proc. 84-58. Failing either to fit the special pre-deficiency situation described above or to satisfy the necessary requirements of Rev. Proc. 84-58, the instant pre-liability remittance must be considered in the nature of a cash bond.

We note in passing that the taxpayer has provided Appeals with neither an in-depth legal argument nor citations to the decisions upon which its position is based. Finding that case law has not changed significantly since the legal analysis contained in Mr. Hill's 1996 memorandum (Attachment 4), and considering the lack of a definite legal argument to the contrary, we find no reason for any additional legal analysis.

To conclude, we find no legal support for the taxpayer's position that the remittance made on [REDACTED] was an advance payment of tax and not a cash bond.

If we can be of further assistance in this matter, please contact the undersigned at ext. 3211.

MATTHEW J. FRITZ  
Assistant District Counsel

By: \_\_\_\_\_

JAMES E. KAGY  
Special Litigation  
Assistant

Attachments:  
As stated.